

## Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-01

INR-07 NSAE-00 USIA-15 TRSE-00 XMB-04 OPIC-06

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TO SECSTATE WASHDC PRIORITY 6252

INFO AMEMBASSY BUENOS AIRES

AMEMBASSY LA PAZ

AMEMBASSY LIMA

UNCLAS SANTIAGO 7058

E.O. 11652:: N/A

TAGS: EFIN, AFIN, AFSP, CI

SUBJECT: DEVALUATION OF PESO, TARIFF REDUCTION, COPPER PRICE,

BALANCE OF PAYMENTS, AND SOCIAL COSTS

1. SUMMARY: GOC MINISTER OF FINANCE SERGIO DE CASTRO HAS ANNOUNCED AN IMMEDIATE PESO DEVALUATION OF 6 PERCENT ACCOMPANIED BY ADVANCED IMPLEMENTATION OF TARIFF REDUCTIONS SCHEDULED FOR JANUARY 1978. PERIODIC DEVALUATIONS FOR MONTH OF AUGUST WILL CONTINUE AT THE SAME RATE AS BEFORE. EFFECTIVE PESO DEVALUATION WILL EQUAL 10.1 PERCENT. END SUMMARY.

2. OVERALL POLICY. GOC SPOKESMAN PLACED DEVALUATION AND TARIFF CHANGES IN CONTEXT FURTHER CONSOLIDATION AND IMPROVEMENT OF ECONOMY. SPECIFICALLY DENIED IS ANY QUESTION OF FORCED DEVALUATION PEGGED TO DEPRESSED COPPER PRICES. INSTEAD, THE GOC HAS CONSISTENTLY EMPHASIZED HEALTHY STATE OF FOREIGN RESERVES AND ABILITY TO FINANCE PROJECTED BOP DEFICIT.

3. COPPER PRICE. LAST BOP PROJECTION JUNE 2, 1977 PREDICTED DEFICIT OF \$120 MILLION WITH SURPLUS IN TRADE BALANCE (BOT) OF UNCLASSIFIED

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\$77.3 MILLION. AS PART OF OVERALL DEFLATIONARY POLICY, ECONOMIC TEAM HAS PERMITTED IMPORTS TO INCREASE APPROXIMATELY 28.1 PERCENT. HOWEVER, LASP BOP PROJECTION WAS BASED ON AVERAGE ANNUAL COPPER PRICE OF 65 CENTS/POUND. ALTHOUGH CURRENT AVERAGE ANNUAL PRICE REMAINS AT 61.69 CENTS/POUND, LATEST SPOT PRICE HAS FALLEN TO BELOW 51 CENTS/POUND. IN ALL LIKELIHOOD AVERAGE ANNUAL PRICE WILL APPROXIMATE LESS THAN 60 CENTS/POUND.

4. BOP DEFICIT. WITH ALL OTHER FACTORS REMAINING CONSTANT, AT AVERAGE ANNUAL PRICE FOR COPPER OF 60 CENTS/POUND GOC WOULD EXPERIENCE BALANCE OF TRADE DEFICIT OF \$14.5 MILLION. MOREOVER, ITS CURRENT ACCOUNT DEFICIT WOULD INCREASE FROM \$348.6 MILLION PROJECTED IN JUNE, 1977 TO \$440.4 MILLION. BOP DEFICIT WOULD INCREASE FROM PROJECTED \$120.1 MILLION TO \$211.9 MILLION AS A RESULT OF A LOSS OF COPPER REVENUE OF \$91.8 MILLION.

5. OTHER EXPORTS. THE PRECISE EXTENT TO WHICH A SIX PERCENT PESO DEVALUATION WILL HAVE AN ENCOURAGING EFFECT ON NON-TRADITIONAL EXPORTS, AND THEREFORE A COUNTERBALANCING EFFECT TO LOSSES IN COPPER REVENUE, IS HARD TO JUDGE. FOR EXAMPLE, RECENT REVALUATIONS DID NOT HAVE THE RETARDING EFFECT ON OVERALL EXPORT EARNINGS AS MANY FEARED, ALTHOUGH IT PROBABLY LOWERED INDIVIDUAL PROFIT MARGINS. THE GOC ASSUMES THAT THIS DEVALUATION WILL HAVE A POSITIVE EFFECT ON EXPORTS.

6. IMPORTS. BY CONTRAST, THE DECREASE IN TARIFFS RATES IS INTENDED ONLY TO COUNTERBALANCE ANY INHIBITING EFFECT WHICH DEVALUATION MIGHT HAVE ON IMPORTS, AND NOT TO INCREASE THEM. SINCE THE PLANNED INCREASE IN IMPORTS IN 1977 OF 28.1 PERCENT WAS PREMISED ON A 65 CENT COPPER PRICE, THIS DEVALUATION MIGHT WELL REFLECT A DESIRE TO HOLD THE LINE ON IMPORTS IN ORDER TO INCREASE MANAGEABILITY OF BOT.

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7. RESERVES. GOC PRESENTLY HAS FOREIGN RESERVES EQUAL TO TWO MONTHS IMPORTS (\$355 MILLION). DE CASTRO HAS POINTED OUT THAT CHILE HAS AMPLE FOREIGN RESERVES, LINES OF FOREIGN CREDIT AND OTHER FINANCING POSSIBILITIES TO SUPPORT A SMALL BOP DEFICIT. AS AN EXAMPLE, HE NOTED THAT THE CENTRAL BANK HAS AT THE PRESENT TIME FOREIGN EXCHANGE LIQUIDITY TWICE THAT OF M1.

8. INFLATION. ASSUMING NO INCREASE, OR EVEN A DECREASE IN PROJECTED IMPORTS, AND INCREASING EXPORTS, WE CAN FORESEE SOME INCREASE IN THE MONEY SUPPLY AND A SLIGHT, BUT CERTAINLY NOT SERIOUS RETARDING OF THE PRESENT DOWNWARD INFLATIONARY TREND. THE 12-MONTH RATE IN JULY FELL TO 83.5 PERCENT. IT SHOULD CONTINUE TO FALL, AND SHOULD ACHIEVE THE 70 PERCENT PROJECTED FOR 1977.

9. SOCIAL COSTS. STATEMENT CONCERNING DEVALUATION AND TARIFF ADJUSTMENT IS NOTEWORTHY FOR THE EXTENT TO WHICH DE CASTRO AND GOC SPOKESMAN SOUGHT TO PUT THESE CHANGES AND OVERALL ECONOMIC POLICY IN CONTEXT OF EFFECTS ON LOWER INCOME GROUPS. ADDRESSING HIS CRITICS, DE CASTRO ARGUED THAT DECREASING INFLATION, INCREASING REAL WAGES, AND OVERALL ECONOMIC GROWTH

PROJECTED AT 8 PERCENT ARE DOING MORE FOR CHILE'S POOR THAN  
RHETORIC ACCOMPANIED BY AN ECONOMIC POLICY BASED ON PROTECTIONISM,  
DEFICIT SPENDING, AND STATE CONTROL. DE CASTRO BELIEVES THAT  
ECONOMIC GROWTH ACCOMPANIED BY POLITICAL STABILITY WILL PERMIT  
THE GOC TO ADDRESS DIRECTLY THE MAJOR ISSUE OF INCOME REDIS-  
TRIBUTION IN FAVOR OF THE MORE IMPOVERISHED. ALTHOUGH INFLATION  
ALONG WITH HIGH COST OF CREDIT WILL CONTINUE TO HOLD FIRST  
PLACE AMONG CONCERNS OF ECONOMIC TEAM, WE FORESEE MORE  
JUSTIFICATIONS FOR EXISTING POLICY EXPRESSED IN TERMS OF  
REDUCING SOCIAL COSTS, AND EVEN MORE POLICY MEASURES DIRECTED  
TOWARDS THAT END.

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